Financial Markets

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(Noon)

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The new year in the financial markets has begun well. The stock market has been rising; the dollar has strengthened to rather astonishing levels; and short-term interest rates have moved down from recent peaks. The major factors behind these developments have been signs of continued but more moderate economic growth and weak growth in M1. Soon, however, the economy's signals may become more mixed. For example, the second year of economic recovery frequently brings sporadic signs of weakness in industrial production and in other indicators. Such signs will be more troublesome than usual this time because 1984 is a presidential election year.

While the Fed always makes policy in a "fish bowl," this factor becomes dominant during election periods. This does not necessarily mean that the Fed becomes more accommodative, but it does have implications for policymaking. The greater degree of scrutiny means that the Fed is under greater pressure to justify fully the policies it pursues. Thus the highly discretionary policy of 1983 might be more difficult to implement in 1984. If the economy shows some signs of waffling by registering a month or two of declines in industrial production, the Fed might find itself under greater pressure to ease than it would in other circumstances. Conversely, if money growth were excessive again this year, the Fed might find it more difficult to tighten because of the political pressures. Election year pressures are generally asymmetrically tilted toward nudging the Fed to be easier rather than to hit its targets at any cost.

Realizing this, the Fed has an interesting policy dilemma for 1984. First, the Fed has already adopted a more discretionary overall ideology. The establishment of a broad credit aggregate last year necessarily meant a greater role for discretion because a credit target--by its very nature--focuses the Fed more on interest rates than does just a money target: Yet for 1984, a discretionary policy will be more risky. Second, discretion or no discretion, most observers focus on M1 as the Fed's most important aggregate. So the Fed will be concerned with setting a viable target for M1 this year. Because of the asymmetric nature of pressure on the Fed, the least risky thing for it to do this year would be to lower the top of the M1 growth range. The current preliminary range allows too much money growth if there is a resurgence in velocity. Let's see why this is so.

Suppose the Fed leaves the M1 range unchanged at 4%-8% growth. If velocity picks up to a normal pace of 3%, the top of the growth range would imply too much growth in nominal GNP: 11%. With 8% money growth and a fast growing economy, the Fed would like to tighten in 1984, but M1 would still be inside its target. Thus, tightening would bring a great deal of pressure on the Fed. On the other hand, if the Fed set the target lower, but found that velocity did not grow, discretion would mean refraining from raising rates: not a position of great pressure.

The February FOMC meeting takes on great importance this year because at this meeting 1984's targets are approved. The FOMC's targets will help to define how the Fed will deal with the risks of the policy environment and set the stage for 1984.

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Market Yields

	1/6/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	11.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	9.38	9.75	8.25
Repurchase Agreements	9.38	10.00	8.25
U.S. Treasury Issues			
Bills			
3 months	9.25	9.33	8.13
6 months	9.67	9.71	8.29
1 year	9.96	10.06	8.58
Coupons			
2 years	10.75	10.84	9.34
4 years	11.31	11.36	9.88
7 years	11.71	11.75	10.29
10 years	11.77	11.79	10.34
Long Bond	11.85	11.86	10.44
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.38	9.65	8.30
3 months	9.45	9.65	8.35
6 months	9.68	9.65	8.40
1 year	10.10	10.10	8.85
Banker's Acceptances			
1 month	9.42	9.90	8.25
3 months	9.47	9.65	8.30
6 months	9.69	9.67	8.40
Eurodollar Deposits			
1 month	9.69	9.81	8.88
2 months	9.88	9.88	8.88
3 months	9.94	9.94	8.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.45	9.96	6.09
1 month	9.50	9.71	8.17
3 months	9.55	9.71	8.54
Bank Holding Companies			
1 month	9.19	9.45	8.17
Dealer Placed:			
3 months	9.60	9.94	8.54
New AA Corporate Utility Bond	13.00	12.88	12.25
Tax Exempt			
6 month Project Notes	5.45	5.50	4.65
1 year AAA Bond	5.60	5.50	5.25
5 year AAA Bond	7.15	7.25	6.20
20 year AAA Bond	9.20	9.30	8.90

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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